

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING # 12-01**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

The application of the Tennessee sales and use tax to incentive programs.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

**FACTS**

[TAXPAYER NAME] (the "Taxpayer"), is engaged in the incentive and recognition industry.<sup>1</sup> The Taxpayer enters into contracts with [REDACTED] (the "Clients") that provide [REDACTED] (the "Participants") with access to incentive programs. Participants earn [REDACTED] ("Points") based upon [REDACTED]. Participants may redeem Points for merchandise.

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<sup>1</sup> [REDACTED]; this letter ruling therefore does not address nexus.

Participants accumulate Points in a database account set up by the Taxpayer and the Taxpayer sends statements to the Participants showing their respective balances. Points may be redeemed during the duration of a particular program for any of the many awards featured in an awards catalogue, which is sent to each Participant at the program outset. The catalogue details the amount of Points necessary to obtain merchandise. Each award has a stated point value for which it may be ordered; the more Points a Participant accumulates during the program, the more awards he or she can earn.

There is no dollar amount associated with Points. Additionally, no cash value is communicated to the Participant relating to the value of the Points. The Participant does not have the option of paying cash for an item featured in the awards catalogue.

The Taxpayer does not use a “bill on redemption” pricing model whereby Clients are billed as merchandise is redeemed by Participants; rather, the Taxpayer bills the Client for the program when award points are issued to the database accounts of the Participants. The Taxpayer invoices the Client on a per point basis (the “Per Point Fee”), unless special customization charges are added. At the time the Taxpayer bills the Client, the parties do not know whether the points will ultimately be redeemed by the Participants or for what type of award (*i.e.*, for merchandise, a gift card, and so on). Additionally, the Taxpayer does not notify the Client when the Participants make selections of awards.

The Taxpayer purchases award merchandise from third party suppliers. The Taxpayer sometimes, but not always, uses a resale certificate to make such purchases. The Taxpayer purchases the items in its own name, not as an agent for the Client; the Client does not take possession of, or title to, the award merchandise. When award merchandise is ordered by a Participant, the Taxpayer ships the merchandise directly to the Participant from its warehouse outside Tennessee (merchandise is generally shipped from [LOCATION]). The Client does not direct the Taxpayer to ship merchandise. The Taxpayer’s Clients are located throughout the United States.

## **RULINGS**

1. Is the Per Point Fee charged by the Taxpayer to a Client subject to the Tennessee sales and use tax?

Ruling: No. The Per Point Fee charged by the Taxpayer to a Client is not subject to the Tennessee sales and use tax.

2. Is Tennessee sales and use tax due with respect to merchandise shipped to Participants in Tennessee?

Ruling: Yes. The Taxpayer must collect and remit Tennessee sales and use tax with respect to merchandise shipped to Participants in Tennessee.

3. If the answer to Question #2 is affirmative, what is the measure of the Tennessee sales or use tax due?

Ruling: The measure of the Tennessee sales or use tax due with respect to merchandise shipped to a Participant in Tennessee is the sales price of the item. The sales price of the item equals the Per Point Fee, multiplied by the number of Points redeemed by the Participant to obtain the item.

## ANALYSIS

### 1. Per Point Fee

The Per Point Fee charged by the Taxpayer to a Client is not subject to the Tennessee sales and use tax.

Under the Retailers' Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, retail sales of tangible personal property and certain enumerated services in Tennessee are generally subject to the sales and use tax. The sales tax does not apply to all services; rather, it only applies to retail sales of those services specifically enumerated by the statute. *Ryder Truck Rental, Inc. v. Huddleston*, 1994 WL 420911 (Tenn. Ct. App. Aug. 12, 1994). Even if a service is not specifically enumerated by the statute, however, the service may be subject to the sales tax where charges for the service are included in the sales price of a taxable good or service. Specifically, TENN. CODE ANN. § 67-6-102(81)(A) (2011) provides that the sales price of a good or service equals the "total amount of consideration ... for which personal property or services are sold," including any services necessary to complete the sale. Thus, when the sale of a non-enumerated service is part of the sale of a taxable good or service, the charges for the non-enumerated service are included in the sales price of the taxable good or service and as such are subject to taxation.

Accordingly, the Per Point Fee will be subject to the Tennessee sales and use tax if the transaction involves 1) the retail sale of tangible personal property; 2) the furnishing of a taxable service; and/or 3) the furnishing of an otherwise nontaxable service that is sold as part of the sale of a taxable good or service.

First, Taxpayer makes no sales of tangible personal property to the Client. TENN. CODE ANN. § 67-6-102(80)(A) defines the term "sale" in pertinent part as "any *transfer of title or possession, or both*, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration." (Emphasis added.) Here, the Taxpayer purchases award merchandise from third party suppliers in its own name. The Client does not take possession of, or title to, the award merchandise. Rather, when award merchandise is ordered by a Participant, the Taxpayer ships the merchandise directly to the Participant from its warehouse outside Tennessee. Accordingly, the Taxpayer makes no sales of tangible personal property to the Client.

Second, the Taxpayer's services are not among the enumerated services that are subject to the Tennessee sales and use tax. As noted above, only specifically enumerated services are subject to the Tennessee sales and use tax. Here, the Taxpayer provides a service whereby it manages an awards and incentive program for a particular Client. No provision of the Retailers' Sales Tax Act subject such services to taxation.

Third, because the Taxpayer does not make sales of tangible personal property to the Client and does not provide a taxable service, no part of the transaction between the Taxpayer and the

Client can be described as the furnishing of an otherwise nontaxable service that is sold as part of the sale of a taxable good or service.

Accordingly, the Per Point Fee charged by the Taxpayer to a Client is not subject to the Tennessee sales and use tax.

## 2. Merchandise shipped to Participants in Tennessee

The Taxpayer must collect Tennessee sales and use tax with respect to merchandise shipped to Participants in Tennessee. Under the Retailers' Sales Tax Act, TENN. CODE ANN. § 67-6-101 *et seq.*, retail sales of tangible personal property in Tennessee are generally subject to the sales and use tax. TENN. CODE ANN. § 67-6-102(78) defines a "retail sale" as a "sale, lease, or rental for any purpose other than for resale, sublease, or subrent." The term "sale" is defined in pertinent part as "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration." TENN. CODE ANN. § 67-6-102(80)(A).

Thus, with respect to merchandise<sup>2</sup> shipped to a Participant in Tennessee, a retail sale will take place if the following requirements are met: 1) there is a transfer of title, possession, or both of tangible personal property to the Participant; 2) such transfer is undertaken in exchange for a consideration; and 3) the transaction is for any purpose other than for resale, sublease, or subrent.

The first requirement is met because the Taxpayer transfers title and possession of the merchandise, which is tangible personal property, to the Participant.

The second requirement is met because the Taxpayer transfers the tangible personal property in exchange for a consideration. Although no cash value is communicated to the Participant relating to the value of the Points, the Points clearly do have value and are thus properly characterized as consideration.

The third requirement is met because the Participant is the consumer of the merchandise and does not purchase the merchandise for resale, sublease, or subrent.

Thus, the Taxpayer makes retail sales of tangible personal property in Tennessee with respect to merchandise shipped to Participants in Tennessee. Such sales are subject to the Tennessee sales and use tax.

In Tennessee, every dealer making retail sales of taxable services or tangible personal property is liable for the payment of Tennessee sales tax. TENN. CODE ANN. § 67-6-501(a) (2011); *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). While the dealer may charge the consumer the appropriate tax, it is the dealer that is ultimately liable to the State. *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252 (Tenn. Ct. App. 1989). Neither a dealer's failure, nor its inability, to collect the tax from its customer will relieve the dealer of this duty. *Smoky Mt. Canteen Co. v. Kitzer*, 247 S.W.2d 69 (Tenn. 1952). In the event that the dealer does not collect and remit Tennessee sales tax on the sales of taxable services or tangible personal

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<sup>2</sup> Note that the sale of a gift certificate is not considered a sale of tangible personal property; therefore, for purposes of this letter ruling, the term "merchandise" does not include gift cards.

property, it will be subject to interest and penalties. *See* TENN. CODE ANN. §§ 67-6-504(b) (2011), 67-6-517 (2011), 67-6-522 (2011).

Here, the Taxpayer is a dealer for Tennessee sales and use tax purposes. Therefore, the Taxpayer must collect and remit Tennessee sales and use tax with respect to merchandise shipped to Participants in Tennessee.

### 3. Measure of the tax

The measure of the Tennessee sales and use tax due with respect to merchandise shipped to a Participant in Tennessee is the sales price of the particular item. The sales price of a particular item of merchandise equals the Per Point Fee, multiplied by the number of Points redeemed by the Participant to obtain the item.

TENN. CODE ANN. § 67-6-102(81)(A) defines the term “sales price” in pertinent part as the “total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, *valued in money, whether received in money or otherwise,*” with no deduction for the seller’s cost of the property sold, charges by the seller for services necessary to complete the sale, or delivery charges. (Emphasis added.)

Here, the consideration for the sale of a particular item of merchandise is the Points redeemed by the Participant. Although no cash value is communicated to the Participant relating to the value of the Points, the Points can be valued in money. The facts state that the Taxpayer invoices the Client on a per point basis; in other words, the Taxpayer receives a set amount of money per Point issued to a Participant. Thus, the Per Point Fee constitutes the value to the Taxpayer of each Point. Accordingly, the sales price of a particular item of merchandise generally equals the Per Point Fee, multiplied by the number of Points redeemed by the Participant to obtain the item.

Importantly, the Taxpayer must either 1) charge the sales tax due on the sales price of the particular item; or 2) indicate on the receipt, invoice, or other record given to the Participant that the stated price of a particular item includes applicable sales tax. TENN. COMP. R. & REG. 1320-5-1-.90 (1974).<sup>3</sup>

Accordingly, if the Taxpayer does not indicate to the Participant that the stated price includes applicable sales tax, the sales price of the item will equal the Per Point Fee, multiplied by the number of Points redeemed by the Participant to obtain the item. The Taxpayer must then collect and remit the sales tax due on the sales price. For example, assume that the Per Point Fee is \$1.00. The Taxpayer’s catalogue states that the Participant may acquire a widget for 100 Points, and the receipt given to the Participant does not indicate that the stated price of the widget includes applicable sales tax. The applicable sales tax rate is 9.5%. For Tennessee sales and use tax purposes, the sales price of the widget is therefore \$100.00 and the Taxpayer must collect and remit an additional \$9.50 in sales tax.

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<sup>3</sup> TENN. COMP. R. & REG. 1320-5-1-.90 states that “[v]endors within the State must indicate in some definite manner whether their customers are paying any Sales Tax. This indication must be stated on the ticket, invoice, or other record given to the customer, or it may be shown by posting a sign in the place of business of the dealer indicating that the prices shown include any applicable Sales Tax.”

On the other hand, if the Taxpayer indicates to the Participant that the stated price includes applicable sales tax, the sales price of an item equals the value of the Points redeemed, less the applicable sales tax. For example, assume that the Per Point Fee is \$1.00. The Taxpayer's catalogue states that the Participant may acquire a widget for 100 Points, and the receipt given to the Participant indicates that the stated price of the widget includes applicable sales tax. The applicable sales tax rate is 9.5%. For Tennessee sales and use tax purposes, the sales price of the item is therefore \$91.32 and the applicable sales tax to be remitted by the Taxpayer equals \$8.68.

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